

“FUTURE MAINTENANCE” FUNDING ISSUES

A Report Prepared for the
Legislative Finance Committee
Subcommittee on Long-Range Building Cash Program Funding

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“FUTURE MAINTENANCE FUNDING” ISSUES

Title 17, Chapter 7, part 206, MCA. Maintenance for state buildings. (1) Subject to legislative determination as provided in subsection (2), *a major capital project* appropriation by the legislature **may** include an amount for maintenance as a part of the appropriation. The amount appropriated for maintenance must be deposited in the long-range building account for use in future maintenance.

(2) A state building recommended for construction in the report to the legislature required by 17-7-203 (*through the long-range building program*) may also be recommended as appropriate for the inclusion of an amount for maintenance. For those buildings recommended for construction, the legislature may allocate an amount not to exceed 2% of the appropriated cost for use in maintenance.

(3) This section does not preclude additional funds, including separate appropriations, donations, grants, or other available funds, from being used for the construction or maintenance of state buildings.

History: En. Sec. 12, Ch. 547, L. 1995.

INTRODUCTION

The 1995 Legislature clearly felt that planning for state building maintenance needs was important, so they authored Title 17, Chapter 7, part 206, MCA to develop additional funds for the Long-Range Building Program (LRBP). To date, this statute has not been used. This section made the funding of maintenance through this code optional for future legislatures. Furthermore, the code is vague, and can be interpreted in a number of different ways. In analyzing the ability to make use of this code in a future-funding plan, a number of issues/questions have arisen: 1) what is meant by “recommended for construction”, 2) when must deposits be made, 3) what is meant by “future maintenance”, 4) could certain funding sources be used in this manner, and 5) can bonded funds be used in this manner. This report will bring to light several of the issues that will need to be addressed if this code were used as the basis for a part of the LRBP funding methodology.

ISSUE 1 – DEFINE “RECOMMENDED FOR CONSTRUCTION”

In the LRBP, “buildings recommended for construction” can take many forms. The analysis of 17-7-206, MCA brought questions concerning the type of construction that would be subject to the future maintenance appropriation. In other words, what does “buildings recommended for construction” mean? In the statute, “major capital project” is mentioned. In the Montana Operations Manual (MOM) 2-98-7, major capital project is defined as any capital project where costs are \$500,000 or greater. For the purposes of this analysis, staff interpreted the code to mean any new structure and new space construction with a cost of \$500,000 or more (in consideration of the MOM rule). The adoption of these criteria means that over the five biennia (1997 Legislature through 2005 Legislature) analyzed, legislatures could have appropriated future maintenance funds on 54¹ projects.

Staff Recommendation: If this statute is used for planned future maintenance funding, amendment of the existing code to clearly define what types of projects are subject to a future maintenance appropriation would be beneficial.

ISSUE 2 –TIMING

In the LRBP appropriation bills, the legislature appropriates and authorizes funds from a wide variety of sources. The source of special concern in this issue is donations. When planning construction of buildings some agencies, for example the University System and the Montana Historic Society, are authorized to raise donated funds for the construction and major remodeling of new building space. It can take many years to raise sufficient donations to undertake the construction of a project. As a result, it becomes difficult to ascertain when

¹ 54 is the total of all new building and building addition projects approved by the 55th through the 59th Legislatures. This number is subject to change with other issues.

a deposit of funds for future maintenance might take place. For this analysis, staff omitted those projects where the full amount of donations has not been raised.

Staff Recommendation: If this statute is used for planned future maintenance funding, additional statutory language directing the timing of the deposit of future maintenance appropriations would be beneficial to the process. The legislature should consider both the deposit timing of donated funds and the deposit timing of the projects funded from all sources.

ISSUE 3 - USE

The statute, 17-7-206, MCA, does not direct the timing for the use of the appropriation except to say, “for use in future maintenance”. The language of the code is vague. There is no direction as to whether the appropriation should be used for the upcoming biennium’s maintenance costs or for creating an endowment through which future interest earnings can be used to fund maintenance (as in the requested analysis). The staff analysis will include the estimated results of each of the uses, immediate use of the funds and deposit of the funds in an endowment trust.

Staff Recommendation: If this statute is used for planned future maintenance funding, additional statutory language directing the exact nature of the use of the funds is recommended. Depending on the wishes of the legislature, the statutes should direct how the funds are to be used, whether for direct/immediate support of the LRBP or for the development of an endowment. If it is the wish of the legislature to develop an endowment, all language necessary for the development and use of a trust will be required.

ISSUE 4 – FUNDING SOURCE QUESTIONS

The funding of LRBP projects comes from numerous sources, and some types of funds have significant limitations associated with their use. In the LRBP, projects are funded with LRBP capital building funds (cash program), state special revenue funds, federal special revenue funds, other funds (primarily donations and university funds), and bonded funds. Questions regarding the use of some of these funds for “future maintenance” have arisen.

Can state special revenue funds and federal special revenue funds be used to fund building maintenance in general? Some of the funding sources, such as state special revenue funds or federal special revenue funds, have specific requirements guiding their use. Assuming it is legal to deposit state special revenues and federal special revenues in the LRBP fund or in a trust for the endowment of future maintenance funds, those funds and their interest earnings would require special tracking treatment. Furthermore, those funds could only be used for projects for which the funds are designated. (reference the information and presentation of Mark Bruno).

Can donated funds be used to fund building maintenance in general? Staff assumes donated funds could be used without limitation for a future maintenance funding source, yet it would be appropriate to request that agencies seeking donations for projects inform potential donors that a portion of their donations would be used for future maintenance.

Can a future maintenance appropriation be made against buildings that are not supported by the LRBP? A number of projects authorized through the LRBP are classified as University non-academic buildings. Non-academic buildings are not maintained with LRBP funds. Maintenance of the buildings is paid through University funds. Some examples of what can arguably be designated non-academic projects² include the Native American Study Center at the University of Montana, new gallery space at the University of Montana, and construction at the Museum of the Rockies at Montana State University, projects all authorized by the 59th

² The status, academic or non-academic, of the three projects has not yet been established. These projects are mentioned only as examples of the types of projects that might be excluded from an additional appropriation for future maintenance funding based on a non-academic designation. However, these projects were among those removed from the list of projects that would be charged for an additional future maintenance appropriation.

Legislature. Appropriating funds in relation to the non-academic buildings might require that the state assume responsibility for all the major maintenance of these buildings.

There are several issues related to using bonded funds for future maintenance, and those issues will be discussed in the following section.

Projects funded with state special revenue funds and federal special revenue funds and University non-academic projects were omitted from this analysis.

Staff Recommendation: If this statute is used for planned future maintenance funding, staff recommends amending statute to include appropriation limitations related to the source of funding. The legislature should give careful consideration to whether it is beneficial to include certain funding sources for appropriation of future maintenance funding.

ISSUE 5 – ISSUES OF BONDED FUNDS

Over a third on the LRBP new building and addition projects make use of bond proceeds, and certain limitations would apply when using the proceeds to provide future maintenance funding. Several questions arose while analyzing the potential of appropriating bond proceeds for future maintenance. Questions include:

- Is building maintenance considered a normal cost of state government? Article VII, Section 8 of the Montana Constitution requires that, “No state debt shall be created to cover deficits incurred because appropriations exceeded anticipated revenue”. This section has been interpreted to mean that the normal operations of the state government cannot be funded with debt.
- Can capital project bond proceeds be used to fund the maintenance of buildings, and can bond proceeds be used to fund the maintenance of buildings other than the building for which the funds were appropriated? Article VIII, Section 11 of the Montana Constitution requires, “All money borrowed by or on behalf of the state or any county, city, town, or other local governmental entity shall be used only for purposes specified in the authorizing law.”
- Would arbitrage rules apply to the LRBP bond issues if bond proceeds were invested in an interest-bearing instrument where the interest would then finance the future maintenance of state buildings? The Internal Revenue Service (IRS) has adopted a number of rules and guidelines that must be followed for a government bond issue to remain a tax-exempt instrument. The rules of concern relate to the yield-restriction requirements, and state as follows:

“The yield restriction rules of section 148(a) of the (IRS) Code generally provide that the direct or indirect investment of the gross proceeds of an issue in investments earning a yield materially higher than the yield of the bond issue causes the bonds of that issue to be arbitrage bonds. However, the investment of proceeds in materially higher yielding investments does not cause the bonds of an issue to be arbitrage bonds in the following three instances: 1) during a temporary period (i.e., generally, 3-year temporary period for capital projects and 13 months for restricted working capital expenditures); 2) as part of a reasonably required reserve or replacement fund; and 3) as part of a minor portion (an amount not exceeding the lesser of 5% of the sale proceeds of the issue or \$100,000).”³

For this analysis, staff assumed that state building maintenance is not considered a normal cost of state government. Furthermore, staff assumed that bond proceeds could be used to fund the maintenance of state buildings and the proceeds could be used for projects other than the original appropriation. Finally, staff assumed that IRS Code 148(a) concerning yield-restrictions would not apply if the additional appropriation were limited to \$100,000 per bond issue. The yield-restriction/arbitrage rule is extremely limiting because the total appropriation for all projects funded from one bond issue would be limited at \$100,000. Often, more than one LRBP project is included in an issue. For this analysis, staff assumed an appropriation of \$100,000 for each LRBP bond issue during the period analyzed.

³ In the IRS publication 4079. “Tax-Exempt Governmental Bonds” pp 6.

Staff Recommendation: If the legislature desires to fund future maintenance with an additional appropriation of bond proceeds, prior to developing the necessary statutes and rules, all questions pertaining to the use of bond proceeds in this manner be thoroughly analyzed through the Legislative Legal staff and by Montana's Bond Council in the offices of Dorsey and Whitney.

As a result of this analysis, 24 LRBP projects over the biennia of 55th Legislature through the 59th Legislature could have an additional future maintenance appropriation included in the cost. Please reference Tom O'Connell's presentation for the financial results of the analysis.

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